

STATEMENT OF MARK MAHER  
SENIOR VICE PRESIDENT, TRANSMISSION BUSINESS LINE  
BONNEVILLE POWER ADMINISTRATION

BEFORE THE

NORTHWEST ENERGY CAUCUS HEARING ON RTO WEST

MARCH 13, 2002

The Bonneville Power Administration (BPA) appreciates the attention the Northwest Energy Caucus is giving to the development of RTO West. Thank you for providing this opportunity to clarify our views. BPA believes the proposed RTO West filing represents a framework for a regional transmission organization (RTO) that has the potential for net benefits to Pacific Northwest electricity consumers. While there are significant unresolved issues, BPA believes we should proceed cooperatively with our RTO West partners and file the RTO West proposal with the Federal Energy Regulatory Commission (FERC) by the end of March for FERC's determination of whether the core elements meet the tests of FERC's Order 2000. There will be subsequent filings of additional documents to round out the proposal and, of course, BPA's participation in the March filing is not a final decision to join RTO West. This statement explains our view on how we should proceed by covering the potential benefits of RTO West, some drawbacks, and key areas of uncertainty. We also discuss the currently identified critical issues that we believe need to be satisfactorily resolved before BPA makes a final decision to join RTO West.

### **Controlling Our Own Destiny**

BPA and eight Northwest investor-owned utilities, known collectively as the Filing Utilities,<sup>1</sup> have worked with regional stakeholders for over two years to develop a RTO proposal that works operationally with the unique Northwest power and transmission system, meets the requirements of Order 2000 and has the potential of yielding benefits to Northwest consumers.

FERC has indicated that it will soon issue a Notice of Proposed Rulemaking (NOPR) on market design standards for wholesale transmission. The Filing Utilities are concerned that the NOPR may contain proposals that are inconsistent with certain proposed RTO West features, which have been designed to handle the uniqueness of the Northwest's predominantly hydroelectric system and accommodate the needs of a broad cross-section of regional stakeholders and public interest groups. The Filing Utilities are working to file their proposal prior to the issuance of the NOPR and to work with FERC Commissioners and staff to explain the need for the flexibility

---

<sup>1</sup> The "Filing Utilities" are Avista Corporation, Bonneville Power Administration, Idaho Power Company, the Montana Power Company, Nevada Power Company, PacifiCorp, Portland General Electric Company, Puget Sound Energy, Inc., and Sierra Pacific Power Company.

described in the RTO West proposal so that the Commission can take the Northwest's needs into account in drafting the NOPR.

BPA believes that RTO West has the potential to produce societal benefits and be accomplished with no appreciable increased risk to the U.S. Treasury. BPA's participation in the March filing is not a final decision to join RTO West. The final decision to participate in RTO West will be based on a number of factors taken as a whole, including:

- BPA's determination that its principles for RTO participation have been met,
- A quantitative and qualitative costs and benefits analysis that demonstrates net benefits for the region,
- FERC's approval of critical elements of the RTO West proposal,
- Guidance from Congress.

### **Potential Benefits of the RTO West Proposal**

An independent consultant, Tabors Caramanis and Associates (TCA), conducted a cost-benefit analysis for RTO West. We believe this analysis is still immature and needs more work, but it validates our intuition that a RTO can create more efficient operation of the system. For the RTO West region, TCA identified a potential annual savings of \$305 in lower generation production costs and lower congestion management costs. These quantified benefits are expected to reduce the market price for energy and reserves within the RTO West region.

These benefits occur because:

- Elimination of pancaked transmission rates reduce the cost to use the existing system by providing access to generators that would otherwise not use the system because of multiple transmission rate charges that are now incurred. The elimination of pancaked transmission rates also increases efficiency of the use of the existing combined systems as more transactions become more economic, resulting in the potential to reduce delivered power costs to consumers.
- More efficient, regional use of generating resources will occur.
- Pancaked transmission loss charges will be eliminated.

- Access to a broader market for operating reserves will be created.
- Increased scheduling efficiency of transmission capacity through reduced requirements for scheduling limits will occur.

Addition benefits we expect from RTO West that are not quantified in the consultant's study include:

Maintaining and enhancing reliability of the Northwest transmission grid.

- Increasing limitation on existing transmission systems have created a situation that would benefit from overall RTO West direction and control. Increased visibility of the larger grid would (1) help prevent cascading outages (sudden, widespread blackouts), (2) allow the system to be put back together more quickly after outages, (3) allow recognition of weaknesses and problems on the overall system by virtue of a single control area operator – the RTO can plan appropriate improvements as a result.

One-Stop Shopping for Wholesale Transmission Services.

- The proposal will provide loads and resources with a centralized resource for transmission information and access.
- RTO West will have authority to provide wholesale services over all wires, regardless of whether they are included in the RTO West Transmission System.

Better, coordinated regional transmission planning, including consideration of non-transmission alternatives and a backstop for planning decisions.

- Under RTO West, regional transmission planning will be performed from a single utility perspective. The planning function will consider least-cost options including transmission and non-transmission alternatives (*e.g.*, demand side management, distributed generation, etc.). The proposed planning backstop authority will allow RTO West to solicit bids from third parties for transmission construction for reliability purposes when fixes are not put in place voluntarily. This will ensure transmission service is reliable and robust.

- The planning process and locational price signals will provide the information needed by multiple entities to make better decisions regarding siting, maintenance, and financing of transmission and non-transmission facilities.
- The planning function will create certainty for merchant generation developers because RTO West will create appropriate price and location signals that should increase the probability that rational and economically sound decisions regarding generation additions can be made.

#### Efficient maintenance and outage scheduling

- Transmission outages needed for maintenance or repair can be better coordinated and scheduled through the authority of RTO West in order to have the least impact on the marketplace. Generators and loads will not have to rely on the maintenance decisions of multiple independent transmitting entities, and RTO West will have the authority to focus scheduled maintenance outages into the most opportune market times.

#### Greater liquidity in the transmission market

- Greater liquidity will make it more likely that new merchant generation will be built in the region. We need this new generation if our economy is going to grow.

#### Regional Accountability

- Users of the region's grid will have a great voice in its management, operation and planning through the membership structure of RTO West.

### **Potential Drawbacks of the RTO West Proposal**

TCA estimated increased transmission costs, including start-up costs and RTO West operations charges to be \$120-145 million based upon the costs to form other regional transmission organizations.

There are other costs that are not quantified such as:

Costs and disruption associated with industry reorganization.

- A major reorganization of this magnitude and scope will consume time and attention of the Filing Utilities' staff and senior managers, as well as other regional officials, representatives, and stakeholders.

Increased complexity of power system operations and complex business operations.

- Market pricing on the transmission system will make transactions more complex.
- A large component of the complexity is the introduction of the scheduling coordinator (SC) role. Bonneville, in its current role as the largest regional transmission and power supplier, has significant experience in successfully managing the complexities that are expected to be a part of the scheduling coordinator's role, but this may introduce additional costs. Smaller utilities, however, will not have this experience. These utilities may require more staff to perform the scheduling coordinator function or have to seek the services of a qualified scheduling coordinator.

Congestion management mechanism.

- The congestion management mechanism causes increased price volatility for transmission when congestion occurs. The mechanism to clear congestion is to redispatch generators (or load if Demand Side Management tools are available) that have participated in RTO West's voluntary, market-bid based redispatch market.

Costs to cover financial risks.

- These costs could include insurance, financial reserves, and other costs that may be incurred to cover financial risks associated with various market-based transactions such as energy imbalance and other ancillary services during periods of high prices and price volatility.

Increase in arbitrations to resolve disputes.

- The RTO West proposals rely primarily on arbitration (with appeal rights) for dispute resolution. Arbitration is easier to trigger than court actions, so the bar for bringing a dispute is much lower.

Potential for gaming with market-based congestion pricing.

- Under some circumstances, load pockets may develop which could give rise to locational market power due to the fact that in the Northwest many generators are located long distances from loads. When transmission becomes congested during extreme conditions, local generators may be able to charge excessive prices for energy or ancillary services.

Cyber security concerns.

- Concerns with cyber security may increase because a single control area operator may be more vulnerable to attack than many smaller separated control area operators.

Currently, the federal transmission system cannot be taxed by state or local entities. The imposition of those taxes on nonfederal operation of the federal system would increase the cost of transmission.

- While this taxation is an uncertainty, the current version of the Transmission Operating Agreement (TOA) provides for these costs to be allocated to the loads in the taxing authority's jurisdiction, thus avoiding a shift of these costs to other transmission users.
- The TOA also provides that any PTO may terminate the TOA if a tax is imposed on RTO West because of its use and control of the federal transmission system.

Liability

- Currently, courts generally hold that transmission providers are not liable for damage to end-use customers caused by outages or other system disturbances when those providers have no privity of contract with the customers. This could change given the drive toward national performance-based reliability standards for electricity service.
- When the federal transmission system is operated by a non-federal entity it will likely lose its defenses under the Federal Tort Claims Act and other federal laws that are available to BPA. Increased liability costs may be passed along to transmission users if RTO West's insurance coverage is inadequate to cover the costs.
- Likewise, RTO West will likely not have the benefit of state tariff protections that the current private transmission providers have against liability for third party business interruption and property claims caused by disturbances on the providers' systems.

Generally, these tariff protections provide for liability only in the case of gross negligence.

- Given these exposures, a system-wide cascading event potentially could result in with liability of the billions of dollars, which (after payment under any insurance coverage) would be passed on to customers through the grid management charge. Limiting this exposure to liability could be accomplished by a revision in FERC policy or federal legislation.

### **Key Areas of Uncertainty Which May Result in Benefits or Drawbacks**

There are also areas that, at this time, we can't tell whether they will result in benefits or drawbacks. These areas include:

Viability of market-driven congestion management model.

- The proposal is untested, and it is unclear whether increased market efficiency will be offset by costs to manage price spikes and complexity.

Decisions of the RTO West board, a board that is independent of transmission owners and other market participants.

- There is tension between creating a board that is responsive to Pacific Northwest interests, but not one that is beholden to any particular interest.
- There is a concern about the ability of RTO West to attract board members and senior managers with the necessary experience and skills, given the complex nature of Northwest power operations.
- The public's access to and influence on decision-making processes will be different than it is today.
- Due to less political influence, there should be less cross-subsidization, increasing efficiency of the use of the combined assets under RTO West management.

Financial sustainability of RTO West.

- This concern is driven in part by recent experiences in California and elsewhere where rapidly rising prices created a cascade of financial and operating problems that caused



major financial and operating disruptions throughout the West Coast market. As a non-profit entity that does not own assets, RTO West may be particularly vulnerable to financial stress, especially during its first years of operations. Any costs imposed on RTO West may be passed through to participating transmission owners and ultimately the region's electricity consumers.

- The ability to manage its financial health will depend on the decisions of the RTO West board and the creditworthiness of parties doing business with RTO West.

Responding to market power abuse.

- While the proposal for a Market Monitoring Unit (MMU) is still being defined, the current proposal calls for a MMU to define and report problems, and RTO West and FERC will be empowered to take action. Questions will remain about whether such measures will be effective remedies to market power abuse.

Once created, it will be difficult to withdraw from RTO West.

- The likely effects of BPA's withdrawal from RTO West participation are either (1) RTO West continues to operate with a scope that probably is insufficient for adequacy of wholesale transmission or (2) the other participants withdraw, effectively collapsing RTO West. In either case, it is uncertain how BPA's system would interact with the remaining RTO or how transmission owners will deal with each other after any collapse of the RTO. There are significant financial obligations that would be associated with withdrawal.

### **Critical Unresolved Issues**

On balance BPA believes the potential for enhanced power and transmission system operations have the potential to offset the costs associated with formation of RTO West and that we need RTO West to help support new generation development. Based on the previous assessment, BPA has identified significant unresolved issues that need to be addressed prior to any decision to execute an agreement to turn over control of our facilities to RTO West. The issues we have identified *do not* need to be resolved before the March filing since we will still have time to

continue our work and present many other proposals to FERC in later filings before making the final call on RTO participation.

At this time, there are nine areas of concern that, depending on how they are dealt with, could alter our view on how to continue with the development of RTO West.

#### Cost-Benefit Analysis

- The RTO West cost-benefit analysis is immature and will change as RTO West development occurs. At this time, the analysis suggests modest net benefits, but BPA customers perceive their transmission costs to be increasing with little power benefit. BPA expects to discuss this issue with its various customer classes.

#### Congestion Management

- The congestion management proposal is complicated and untried although similar models are in operation. Thus, the congestion management proposal needs further testing. It has the possibility of providing transparency to the problems of congested paths, and the value of relieving transmission constraints through investment of transmission or the beneficial siting of generation. It could, however, cause cost shifts and price volatility.
- Accompanying the congestion management proposal is a cataloging process that would catalog existing contract rights and the transmission assets needed to support such rights. There are a number of potentially controversial and difficult issues associated with cataloging. Cataloging will require BPA and its customers to resolve many long-standing issues related to transmission rights and usage, which in turn may lead to an increase in an alternative dispute resolution process. Without further testing of the cataloging process, BPA is concerned that cataloging may result in BPA being forced to bring more transmission assets to meet its existing contracts due to the loss in flexibility that BPA currently has as a control area operator.

## Liability

- The risk due to increased tort liability exposure as a result of RTO formation threatens to swamp net benefits of the RTO. This is a national issue and deserves active consideration. It is an issue of particular importance to BPA and its customers because BPA has certain defenses under the Federal Torts Claims Act, in particular the discretionary function defense that we do not believe would be available to RTO West in undertaking the same activities as BPA would in operating the transmission system. The RTO would also lack state tariff protections that distribution utilities have from third party liability business interruption and property claims. The potential exposure to a system-wide cascading event is in the billions of dollars. Financial and regulatory tools may need to be put in place to avoid these large costs.

## Credit Worthiness

- The credit worthiness of potential scheduling coordinators creates risk to RTO financial viability. If a scheduling coordinator defaults on its obligations, the cost of that default potentially could be spread to the remaining scheduling coordinators and their transmission customers. BPA is working with the other Filing Utilities to define ways to ensure that RTO West has standards that establish the continued credit worthiness of scheduling coordinators and other parties it does business with. The Filing Utilities also are exploring the potential for a backstop scheduling coordinator to immediately perform the functions of a defaulting scheduling coordinator.
- BPA will be the scheduling coordinator for its customers who do not convert to RTO West service. BPA is currently working out which scheduling coordinator services will be offered to our various customer classes. We are also working out issues associated with ancillary services, liability for generation and load performance, and the allocation of risks. These issues are likely to be controversial.

## Facilities Inclusion

- The issue of which facilities will be included in RTO West creates a legitimate concern for approximately half of BPA's public utility customers who receive service across investor-

owned utility transmission lines through general transfer agreements (GTAs). The issue for customers is about the price and quality of service they will receive with an operational RTO West. The investor-owned utilities are attempting to categorize certain of their transmission as distribution, and therefore not subject to RTO West control, even though a number of BPA public utility customers receive service over those lines. BPA is proposing to turn over control of all of its transmission facilities to RTO West. BPA believes that the other Filing Utilities should include all of their facilities that are necessary for wholesale transaction to BPA's GTA customers.

#### Transmission Development

- BPA believes that there is a strong need for the development of transmission in the Northwest to minimize congestion. The formation of an RTO that uses market principles to relieve congestion and provide ancillary services emphasizes the importance of appropriate transmission infrastructure development prior to forming the RTO. RTO West could be seriously wounded if initiated under circumstances of significant transmission infrastructure deficiency.

#### Control Area Responsibilities

- Elimination of BPA's control area responsibilities may result in new or different costs to BPA customers. BPA currently "manages" its system and protects against imbalances as a control area operator for its customers. Such charges will be revealed when RTO West makes the imbalance charges visible in its role as the ancillary service provider of last resort. BPA does not have the ability to self-provide and self-track these charges to minimize the risk of any changes to its customers.

#### Transmission Adequacy Standards

- Adequacy of the transmission grid is extremely important for system efficiency and reliability. Negotiation of adequacy standards, and their application via the cataloging process to assure RTO West has sufficient resources to meet all the obligations it serves will likely be contentious, but necessary. The varied interests of the transmission owners as well as the transmission customers' views of their current rights under existing transmission

contracts will influence the negotiations of these standards. It will be necessary to seek public input in developing these standards, and BPA will work closely with its customers to assure sufficient assets are available to satisfy current obligations are met under RTO West.

#### Governance

- BPA is working to assure the governance structure of RTO West will be established in a manner that assures sound business operations but also responds public input.

While BPA intends to proceed without legislation, we also continue to believe legislation should ultimately be pursued that authorizes BPA to participate in an RTO and suspends some of the Administrator's statutory transmission-related responsibilities for the duration of BPA's participation in the RTO. We believe this will create greater stability necessary to support the large financial investments associated with the formation of RTO West. FERC's requirements for the independence of RTO's in their management and control of transmission systems raises significant issues as to the degree to which the Administrator can sub-delegate his statutory responsibilities and contract out functions. Even apart from this, certain statutory procedural requirements apply to BPA, such as the requirement that BPA conduct a formal evidentiary proceeding to establish rates for users of its system. Meeting those requirements, while the RTO is dealing in its own sphere with the same subjects, raises a number of legal issues that might only be resolved through very cumbersome and inefficient efforts to fit the RTO and BPA processes together. The BPA subtitle of H.R. 3406, introduced by Rep. Joe Barton, addresses all these issues in a manner that avoids BPA's concerns.

In addition to the issues we have identified that need to be addressed, there are qualities of the RTO West filing that we believe are critical. These qualities include:

- Preservation of historical contract rights.
- Approval of billing agent provisions that ensure the security for Energy Northwest bonds
- Establishment of a company rate.
- Transmission reservation fee—a charge for parties that currently do not have long-term contract rights (necessary to avoid cost shifts)

- Participation in RTO West does not create the right for FERC to regulate BPA's power business.
- Geographic scope is limited to the scope permitted by the filing parties.

In conclusion, BPA believes the proposed RTO West filing represents a framework for a Northwest RTO that has the potential for net benefits to Pacific Northwest electricity consumers and the potential for no increased risk to U.S. Treasury. We believe BPA should proceed cooperatively with its RTO West partners to make the next substantive filing. BPA's participation in the March filing is not a final decision to join RTO West. As discussed, there are significant unresolved issues that could cause BPA to reconsider its support for RTO West.

BPA remains committed to working with the Pacific Northwest congressional delegation and the region to design a RTO that meets the region's needs. We strongly believe your thoughts and concerns have helped us develop a better proposal. Thank you for your heightened interest in this issue.